

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLEE**

ORIGINAL
77-7069

United States Court of Appeals
SECOND CIRCUIT

BALLON, STOLL & ITZLER,

Plaintiff-Appellant,

against

THOMAS J. DUFFEY, HERMAN A. LEUKING, JR., ALBERT D. MATHESON, WILLIAM J. KENNEDY, JOHN A. MURPHY, JACK A. SHEETZ, JOHN SPICKERMAN, FRANK E. FITZSIMMONS, ROBERT HOLMES, DONALD PETERS, WILLIAM PRESSER, ODELL SMITH, ROY L. WILLIAMS, FRANK H. RANNEY and JOSEPH MORGAN, not individually, but as Trustees Under a Common Law Trust of the Central States Southeast and Southwest Areas Pension Fund,

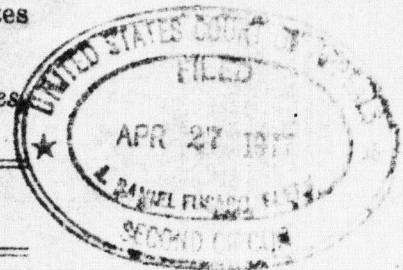
Defendants-Appellees

BRIEF FOR DEFENDANTS-APPELLEES

GREENBAUM, WOLFF & ERNST
Attorneys for Defendants-Appellees
437 Madison Avenue
New York, N. Y.
(758 4010)

Of Counsel:

SYDNEY J. SCHWARTZ
LAURENCE VOGEL



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-against-	:	
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JOHN SPICKERMAN, FRANK E. FITZSIMMONS,	:	
ROBERT HOLMES, DONALD PETERS, WILLIAM	:	
PRESSER, ODELL SMITH, ROY L. WILLIAMS,	:	
FRANK H. RANNEY and JOSEPH MORGAN, not	:	
individually, but as Trustees Under a	:	
Common Law Trust of the Central States	:	
Southeast and Southwest Areas Pension	:	
Fund,	:	
Defendants-Appellees.	:	

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BRIEF FOR DEFENDANTS-APPELLEES

STATEMENT OF ISSUES PRESENTED

The statement of issues presented in appellant's brief is, in our opinion, neither complete nor accurate. We accordingly restate the issues as follows:

1. Is the finding of the district court that there was factually no agreement between plaintiff and defendants for the payment of plaintiff's fees supported by sufficient evidence

warranting the dismissal of the first and third causes of action alleged in the amended complaint?

2. Is the finding of the district court, that there was no evidence to sustain the second cause of action sounding in fraud, correct?

3. Are lawyers estopped as a matter of public policy from invoking the court's aid to recover legal fees for services rendered by them to a debtor in possession in a Chapter XI proceeding where, in violation of Bankruptcy Rule 215 and Rule 10 of the Bankruptcy Rules of the Southern District, they failed to disclose to the court in a petition and supporting affidavit for an order approving their retainer a "connection" (an alleged contract for the payment of their fees) with the debtor's principal creditor?

4. Is there any jurisdiction under New York State CPLR Section 302 (the long arm statute), where the only acts performed by defendants or their agents in New York involved the protection of defendants' assets in the bankruptcy proceeding of a New York debtor?

STATEMENT OF THE CASE

Plaintiff, a firm of attorneys practicing in New York, brought this action to recover for legal services rendered by it to Neisco, Inc. ("Neisco") in its Chapter XI proceedings in the Southern District, between the time of the filing of the petition (November 24, 1969) and the time of adjudication (March 22, 1972). The action was not brought against the debtor, Neisco. It was brought against the defendants, as trustees of the Central States Southeast and Southwest Areas Pension Fund (a common law trust, hereinafter referred to as the "Fund"). The Fund was a secured creditor of Neisco at the inception of the proceeding, in an amount exceeding the total value of all of its assets.

THE PLEADINGS

The complaint, as amended (A22),* alleges three causes of action. The first is based on contract, the terms of which are specifically stated in paragraph Seventh (A23-24). It alleges that the Fund undertook to pay plaintiff for its services if it agreed to render all of the legal services required by Neisco, in the Chapter XI proceeding. Paragraph Eighth alleges that the plaintiff performed such services.

* The letter "A" preceeding a number indicates the page of the Joint Appendix. The letter "E" indicates the page of the Exhibits volume.

Paragraph Tenth alleges that the reasonable value of the services was \$100,000, of which \$25,000 was paid, leaving due a balance, which, with disbursements of \$731.06 (Paragraph Eleventh A24), comes to a total of \$75,731.06. It is this sum which is sought to be recovered in this action (A24-25).

The second cause of action realleges the facts pleaded in the first and also states that the Fund "unconditionally warranted and represented to plaintiff that defendants would take all necessary steps and furnish all of the funds required to confirm said arrangement proceeding, including payment for the legal services to be rendered by plaintiff in the Chapter XI proceeding and all other administration expenses of such proceeding" (Paragraph Fifteenth A25). The second count also alleges that the plaintiff relied upon these representations and warranties, rendered the legal services, that the representations and warranties were false and fraudulent, and that defendants did not intend to provide the funds required for confirmation (A25-27).

The third cause of action repeats the allegations of the second cause of action, except that it is pleaded in contract and alleges a claimed breach by defendants in their refusal to furnish the funds necessary to obtain the confirmation of a plan of arrangement (A27-29). This count was first included in the Amended Complaint, served over one and one-half years after the action was commenced.

Defendants, in their answer to the amended complaint, plead denials of all of the essential allegations of fact (A13), a first defense of lack of jurisdiction and a second defense in the nature of estoppel based upon the failure of plaintiff to disclose the alleged fee arrangement with the Fund in its verified application to the Bankruptcy Court for appointment as attorney for the debtor in possession. The affidavit submitted to the court, a copy of which is attached to the answer as Schedule A thereof, stated under oath that plaintiff had no connection with any creditors of Neisco (A21) when it is an undisputed fact that at all relevant times defendants were the largest single creditor of Neisco. (See Complaint, paragraph Sixth A23).

A Review of the Evidence

At the trial, to support plaintiff's contention, it produced as witnesses Frederick E. M. Ballon, Ronald S. Itzler, and Jack Polish. Each of these witnesses was interested in the event, the first two as parties-plaintiff and Polish because he was then engaged in representing Ernest Horvath in a litigation pending before Judge Bonsal in the district court (A692-95)* in which he claimed, on behalf of Horvath, a contract of life

*-Horvath v. Duffey et al, 73 Civ. 1248(DBB)

employment, coupled with an undertaking to fund an arrangement of Neisco in the Chapter XI proceeding along the same general theories urged by plaintiff (cf Opinion Bonsal, J. E324 et seq). In addition to the oral testimony of these witnesses, plaintiff offered various excerpts from the bankruptcy hearings and other documents which we will discuss in the argument portion of the brief.

To controvert plaintiff's evidence, defendants offered the pre-trial depositions of two of the trustees, Duffey and Matheson, (marked as plaintiff's Exhibits 23 [E134] and 24 [E189], the testimony of Joseph Radom, formerly an attorney for the Fund, numerous exhibits and extensive excerpts from the Bankruptcy hearings. Radom was a disinterested witness since he had not represented the Fund for upwards of a year and a half prior to the trial (A648) and had no interest in the outcome of this case.

The essential testimony of Ballon was to the effect that at a meeting at the Fund's offices in Chicago called, inter alia, to discuss Neisco's financial problems (A162-72) he was told to proceed with the Neisco Chapter XI reorganization, that he had estimated that his fee would be \$100,000, of which \$25,000 was to be paid immediately out of the Montmartre Hotel, also owned by the Horvath interests, and that the \$75,000 balance would be "third party money" coming from Montmartre or some other company.

He also testified that if Neisco were to pay the fee directly it would have to be fixed by the Referee in Bankruptcy. Ballon testified that Matheson approved the additional fee of \$75,000 which was to be paid by a third party (A173-84). The testimony is quite clear that Ballon did receive \$25,000 from Montmarte but not before the petition was filed (A186; Def. exh. B E234; Plf. exh. 9 E21) and that the checks were countersigned by a Fund representative whose function was to prevent diversion of funds by the Horvaths out of the Montmarte where the Fund was also a substantial creditor (A186).

Ballon testified that various Montmarte problems were discussed at the Chicago meeting and that at subsequent meetings Montmarte and other problems were discussed (A173, 194). He further testified that a meeting took place in New York on November 11, 1969, prior to the filing of the petition, at which were present, Radom, Joseph Teitelbaum, an independent legal advisor to the Fund, Ernest's brother George, Polish, and two accountants for the Fund and Neisco. They discussed a proposed order for certificates of indebtedness in respect of \$1,600,000 to be advanced by the Fund to enable Neisco to operate during Chapter XI and to bring it to the point where a successful arrangement might be approved (A194-95). What is directly to the point is that in discussion of Montmarte and other problems, (we quote the direct testimony of Ballon) "all those problems had to be resolved in order to satisfy the Fund to go ahead and make the advance and

loan and to fund and supply the funds necessary to consummate the Chapter XI plan in the Neisco Corporation" (A196). Ballon further testified that at a meeting in Chicago on November 19, 1969 (A197), also before filing the petition, the parties, among other things, discussed the expense of the plan of arrangement and Ballon was told by Matheson that he could proceed within the overall limit of \$300,000 for all expenses, including payments to creditors, to the government, etc., (apart from the \$1,600,000) and he was again instructed to proceed with the Chapter XI reorganization (A199-202, A281). He testified that he was also told that the Fund would employ someone to oversee the withdrawals from the Neisco checking account and would have a counter-signatory on the account. This eventually turned out to be Irwin Rugendorf, who was retained by the Fund for that purpose. (A205-206).

Ballon's testimony, like that of the other two plaintiff's witnesses, was quite general and non-specific. Essentially he related conclusions, parroted substantially the same language with respect to each meeting; but rarely was he able to state with any accuracy specifically who said what (cf A224-30, A353-54). At no time did he get any writing confirming the alleged retainer, and in none of the correspondence, which we will analyze at a later point, was there any mention specifically made of any undertaking by defendants to pay plaintiff's fees, independently of funding an arrangement, if an arrangement could

be arrived at (cf. 313-15).

The proffered plan of arrangement which he identified is extremely vague in its content (Plf. exh. 2, E2) and has specificity only in relation to the percentage of dividend to be paid to general creditors. The settlement of the government's claim is not mentioned; it is to be paid in full unless otherwise agreed by Neisco and the government. No amount of fees or other administration expenses are mentioned, nor any source for their payment. As matters later turned out, if the Horvaths' demands had been met the Fund would have been required to undertake a total obligation of \$1,257,000* (exclusive of the Ernest Horvath employment guaranty) to fund the plan of arrangement, rather than the \$300,000 limit which the witness, Ballon, testified Matheson put on the arrangement.

On cross-examination Ballon was interrogated extensively on the question of conflict of interest (A307-319, A323-33). We will reserve discussion of this for a later, specific point (infra p. 36). No bill or statement of fees was ever rendered by plaintiff to the defendants prior to the adjudication in bankruptcy of Neisco; actually a bill is claimed to have been sent about two months after adjudication, a week or two before this action was instituted (Plf. exh. 10 E22).

*See Schedule A attached, computing this figure, infra. p.49.

Itzler's testimony might best be characterized as of the "me too" variety. He handled most of the mechanical details of preparation of papers and attendances at hearings before the Referee in Bankruptcy. With respect to the basic conferences between the parties he claimed to have been present at some of these conferences, primarily as a listener. There were six meetings* at which he testified that he was present; but on cross-examination he admitted that his daily time sheets showed no time on his part indicating his presence at three of these meetings,** nor the Fund's presence on December 10, 1969, at a creditors meeting (A479-80).

His testimony, like that of Ballon's, was extremely general and conclusory rather than factual (cf A382-405), repeating the same general story for each meeting. When pressed he could offer no reason for the repetitive discussion of payment of fees on six occasions, in the light of plaintiff's claim that the matter had been agreed at the first conference in Chicago. He suggested anxiety as a reason, but did not explain why no written confirmation had been obtained to alleviate such anxiety (A468-69).

* One between 11/24/69 and 12/29/69 (12/5) (A380-81); 12/10/69 (A387); 2/24/70 (A390); 4/6/70 (A393); 4/20/70 (A398); 6/9/70 (A402).

**One between 11/24/69 and 12/29/69 (12/5) (A475); 4/6/70 (A481); 6/9/70 (A482-83).

Itzler carried the alleged discussions that he overheard to a point which approaches reductio ad absurdum (later carried to its ultimate by Polish). He testified that he had overheard a discussion between Radom and Ballon of the funding of the plan of arrangement and its expenses (this at the meeting of April 6, 1970 at which he has no time entries of being present); that the discussion focused on the Fund financing the plan and the expense of the Chapter XI and that there was no discussion of any conditions or any limitation with regard to settling the various outstanding claims or expenses. (A395, A485-89, Plf. exh. 2 id. E2, A25) In other words, it was Itzler's testimony that the Fund undertook to finance the plan in the form of a blank check, unlimited in amount.

He testified that a draft of an agreement with the Fund was forwarded by him to counsel for the Fund in July of 1970, which, however, was never signed. (A406-11, Plf. exh. 15, E87) It should be noted that the letter of transmittal dated July 27, 1970 (Plf. exh. 16, E92) recites that the consummation of a plan depends on the execution of these agreements.

On re-direct, Itzler testified that there was never any question but that the Fund agreed to pay plaintiff's fees, whether or not the Chapter XI proceeding was successful in achieving a plan of arrangement; in other words, reiterating the unconditional nature of the alleged agreement (A489, A496;

but see Polish contra, A727-28). He did not at any time dispute his statement to the Bankruptcy Judge that "If I (plaintiff) am paid, I will be paid by Neisco" (Def. exh. J, Tscpt. 2/1/72, Smp. 10, lines 5-6 E257). Even as late as this occasion, he made no claim of any contractual obligation on the part of the Fund to finance the plan of arrangement (Def. exh. J, Smp. 13 line 22-Smp. 15, line 14 E261-62).

Polish testified that he had represented George Horvath and his companies, including Neisco, over a period of years, that he still represented Horvath, that he was house counsel for Neisco, that he was present in Chicago on November 5, 1969 (A681-83). He also testified to what he heard of the alleged agreement (A684-88). When pressed on cross-examination he stated that the agreement to pay fees was unequivocal and without condition and that the undertaking to finance the reorganization would have required the Fund, as he understood the agreement, to pay whatever was necessary, even if it involved payment of the government claim in full and the creditors in full (A716-17, A720-21; "over a million dollars" A725).

He indicated that George Horvath was most reluctant to go forward with the Chapter XI proceeding and that at the meeting on November 19, 1969 in Chicago, he attempted to convince George Horvath to go along with the Chapter XI proceeding (A700-01) (very curious testimony since it developed on cross-

examination that George Horvath had signed the Chapter XI petition on November 6, 1969, 13 days previously (Def. exh. A A19; E233).

Polish confirmed that the payment of \$25,000 on account of plaintiff's fees did not come from the Fund but came from Montmarte, one of the Horvath corporations. He testified that the \$25,000 was not paid before the petition was filed because Montmarte did not have the money at that time and had to await the receipts of the Christmas season in Florida when it did acquire sufficient funds to make the payment (A745). The suggestion that the Fund made this payment is implicit in the pleadings (cf A24, A29) and much of the testimony of plaintiffs. The record is quite clear that the Fund did not make the payment and that it merely acquiesced in it to the extent of permitting its nominee to countersign Montmarte's check (A687). The testimony of Polish, like Ballon and Itzler, was couched in generalities; little or no direct conversation was related nor any specific identity of who said what except that Polish said that Teitelbaum (now deceased) did most of the talking on behalf of the Fund. He admitted that the meeting in Chicago was the first occasion on which he met Radom (A684) and Radom testified in this connection that the only prior occasion that he met George Horvath or anyone on behalf of the Neisco group was a few months before (A529).

Radom's testimony was quite clear that there was no agreement by the Fund to pay plaintiff's fees at any time (A534-36, A673). He stated that if a plan of arrangement were ultimately arrived at, of necessity, the Fund would be the only interested party capable of financing it (A670). Any financial support for a plan depended upon the plan being satisfactory to the Fund. Radom was specific that this required not only the resolution of the Neisco problem but also of all of the other Horvath problems which were inter-related, namely Masmó, Montmarte, Mt. Clemmons, and various others (A545-54). The notes for the first \$25,000 payment to plaintiff for fees were notes of Montmarte, not of the defendants. He categorically denied that the Fund ever agreed to make payment of plaintiff's fees as it alleged and claimed. (A544, A554-56). The first discussion as to amount of fees took place in August 1971 (A554-56).

SUMMARY OF ARGUMENT

1. The evidence is more than sufficient to sustain the factual findings and the conclusions of law of the district court that there was no express or implied agreement between the Fund and the plaintiff to pay its fees, or to fund a plan of arrangement without limitation, and that there is no contractual basis for plaintiff to recover (A827-30).

2. The finding of the district court that there is no evidence of fraud (A833), is fully supported by the trial record.

3. Plaintiff is estopped from any recovery in this action by reason of its violation of Rule 215 of the Bankruptcy Rules (former General Order 44) and Rule 10 of the Southern District Bankruptcy Rules. The district court found that plaintiff had failed to comply with the rules and that if it had made application to the district court for a fee allowance it would have been denied (A825; cf discussion A822-24). The district judge's ruling, however, that the violation of the Bankruptcy Rules would not preclude the intervention of the court to enforce a fee arrangement between counsel and a third party creditor (A826-27) is, we submit, against public policy. Such a result would sanction the approval of a secret agreement detrimental to the debtor's estate and its creditors in contravention of the specific policy of the Bankruptcy Rules.

4. The finding of the district court that there was

a sufficient basis of in personam jurisdiction under the New York Long Arm Statute, CPLR Section 302, by reason of the acts of defendants' agents in New York to protect the Fund's interest in the Chapter XI proceeding (A818-22), impinges upon the sovereignty and independence of the federal courts in bankruptcy.

The district court erred in imposing a burden upon a nonresident's ability to litigate in the federal courts and to come into a foreign jurisdiction for the purpose of protecting his federal rights.

POINT I

THERE IS AMPLE EVIDENCE TO SUPPORT THE DISTRICT COURT'S FINDING THAT NO AGREEMENT WAS ARRIVED AT BETWEEN PLAINTIFF AND DEFENDANTS UNDER WHICH DEFENDANTS AGREED TO PAY PLAINTIFF'S FEES FOR REPRESENTING NEISCO.

Plaintiff below claimed that there was express agreement(s) by defendants to do two things:

(a) Pay plaintiff's fee willy-nilly without regard to the outcome of the Chapter XI proceeding (Complaint, paragraph Seventh, A23), and

(b) Fund the Chapter XI proceeding of Neisco without regard to its cost (Complaint, paragraph Fifteenth, A25).

The district court found that no such agreements were entered into by defendants. There are three areas of reference which to our mind conclusively demonstrate that the district court did not err and that no agreements of the character claimed by plaintiff were ever arrived at. These areas are:

(1) The inherent illogic of such an agreement, in either of the forms claimed by plaintiff.

(2) The numerous statements made by plaintiff in the course of the Chapter XI proceedings, to which reference will be made, in which they took positions completely inconsistent with the existence of any agreement, in addition to specific, damaging admissions by plaintiff.

(3) The correspondence between the parties, particularly the letters signed by plaintiff, and the Fund minutes, all of which indicate quite conclusively that the Fund undertook no obligation, unless it was able to settle in a package all of its outstanding problems with the Horvaths, a result that was never accomplished.

Before proceeding to a discussion of the evidence in relation to these three areas, it might be well to restate the guidelines for review by this Court of the decision of the district judge. Rule 52(a) of the Federal Rules of Civil Procedure provides that in a case tried by the court without a jury "findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses." Zovluck v. United States, 448 F.2d 339 (2d Cir. 1971), cert. den, 405 U.S. 1043 (1972); Lassiter v. Fleming, 473 F.2d 1374 (2d Cir., 1973). See also United States v. U.S. Gypsum Co., 333 U.S. 364, 395, (1948); Guzman v. Pichirilo, 369 U.S. 698, 702, (1962); Case v. Morrisette, 475 F.2d 1300, 1306-08 (D.C. Cir. 1973); United States v. Florida, 482 F.2d 205, 207-09 (5th Cir. 1973).

In this connection it must be pointed out that the plaintiff's case is based almost entirely on its own interested testimony and that of the witness, Polish, who was

just as interested as it, considering that he was counsel for Horvath in a case which arose from the identical transaction and which is still sub judice in the Southern District. In this regard the statement of the Supreme Court in the Guzman case, supra, (p. 702) is of direct guidance; "A refusal to credit the uncorroborated testimony of the director - partner, who obviously was not disinterested in the outcome of the litigation, would not be considered clearly erroneous."

It is of more than passing interest that at no point in the appellant's brief is there any discussion of the burden upon appellant of showing that any findings of fact of the trial court were clearly erroneous within the concept of that term as it has been applied by this Court under Rule 52 (a). We shall now proceed to discuss each of the three areas above.

(a)

The inherent improbability of the agreements which the plaintiff alleges and in support of which two of its partners testified is apparent. The motivation for such an extreme position is also evident when we consider that any lesser position would have required a meeting of the minds on some basic terms which would have constituted an offer and acceptance in the nature of contract law. By claiming the Fund

agreed carte blanche to fund any plan of arrangement, no matter how costly, the need for offer and acceptance and a meeting of the minds to establish a contract is satisfied. The fact that it is so illogical as to be beyond reality and so improbable that it cannot be accepted as a matter of fact does not detract from the theoretical legal concept which plaintiff perforce had to plead. We suggest that it is quite apparent that plaintiff's witnesses were rationalizing the facts to fit the conclusion needed in order to establish a theoretical contract.

From the viewpoint of reality, any claim that the Fund made a carte blanche agreement to finance any plan of arrangement that might be arrived at is sheer nonsense. A carte blanche agreement would have subjected the Fund to liability for a potential payment of creditors in full, the government in full and all expenses of administration without limit. This could have added up to over \$1,257,000 (supra pp. 9, 12; Schedule A, p. 49).

All of the witnesses on both sides agreed that the purpose of the Chapter XI proceeding was to preserve Neisco as an operating company in which condition it would have had substantially greater value than if it had been thrown into bankruptcy by foreclosure and its assets sold at auction. The Fund's liens exceeded the entire value of the Neisco assets and the Fund could have taken over Neisco lock, stock and barrel by

foreclosure at any time. If it had, its loss would have been far less than the amount of money it advanced to Neisco to continue operating (\$1,600,000) plus the potential liability for the carte blanche agreement to fund a plan of arrangement which plaintiff would have us believe the Fund agreed to. The absurdity of such a state of affairs is evident. The absurdity of the situation is further compounded by the fact that the Fund would have still been faced with the personal demands of the Horvaths, the Montmartre problem, the Masmo problem and myriad other items which were outlined in the letters which are discussed in section (c) infra (pp. 29-32).

Considering the extent of the Fund's lien against the Horvath companies, it is just not rational to assume that with Masmo facing bankruptcy, Montmartre facing foreclosure, and Neisco facing Chapter XI, the Fund would have made a carte blanche agreement on any subject without a satisfactory all around settlement of its multitude of problems with the Horvaths. The correspondence (infra, pp. 29-32) and the Bankruptcy Transcripts (infra, pp. 22-28) and Ballon's admissions in testifying (A266-79, A284-87, A299-305) conclusively support defendants' position.

Moreover, it is incredible to conceive that an agreement to pay a specific fee would have been made by the Fund without reducing it to writing. The fact that there is not even a hint of such an agreement in any writing, whether

to or from the Fund, supports our characterization of plaintiff's claim as "incredible." Further erosion of plaintiff's position is evident from the incontrovertible fact that a \$25,000 retainer was paid to plaintiff, not by the Fund, but by a Horvath company, Montmartre. It is uncontradicted by plaintiff's witness, Ballon, that the figure of \$100,000 mentioned by him was not a fixed fee but was an estimated limit and that it would be fixed by the Referee if paid out of funds supplied to Neisco to fund an arrangement on a basis of quantum merit. There are several points in the testimony where all of the witnesses agreed that such procedure would apply, and that the fee would have to be subject to the approval of the Bankruptcy Court and this was acknowledged to the Bankruptcy Referee (Def. exh. J, Tscpt. 2/1/72, Smp. 52, line 13-Smp. 55 line 10, E299-302). The following colloquy would seem conclusive: (Smp. 52, line 14-Smp. 53 line 9, E299-300)

"The Referee: . . . What are we going to do about administration expenses, fees and allowances?

Mr. Itzler: I would like an opportunity to discuss that problem with the representative of the Pension Fund. In the event we cannot arrive -- you are talking now of attorneys' fees?

The Referee: I am talking generally. The expenses of administration, be they creditor committee, attorneys, accountants, all of them.

Mr. Itzler: I mention [sic] it to Mr. Radom before. We have not discussed it at length. I would like to attempt to have the Pension Fund pay these expenses as an outside party. If we can't agree on a figure, we will then make application to the court for the granting of allowances. I am sure the creditors committee will do likewise."

Not a word is said here by Itzler, one of plaintiff's partners, in support of an agreement of any kind, to say nothing of an agreement for \$100,000.

(b)

The Neisco Chapter XI proceeding continued from November 24, 1969 through March 22, 1972, a period of two years and four months. During this period, hundreds of pages of testimony were recorded at hearings before the Bankruptcy Court and on scores of occasions statements were made both by Itzler and in his presence which are inconsistent with any claim by plaintiff that (1) the Fund had agreed to pay its fees without qualification at a given amount of \$100,000, or on any other basis, or (2) the Fund had undertaken, prior to Neisco filing its Chapter XI petition, any contractual obligation to fund any proposed plan of arrangement, whether or not acceptable to it. The record below is replete with extracts from the transcripts where these statements are found. A selection of typical references is quoted in the Appendix (A760-99) and some

excerpts are set out in this section of the brief as follows*:

Tscpt. 2/1/72, Smp. 10, lines 5-6,
E257:

"Mr. ITZLER: I represent Neisco.
If I am paid, I will be paid by Neisco."

Tscpt. 2/24/70, Smp. 90, line 25 to
Smp. 91, line 17:

"We have discussed with Mr. Radom, as representative of the fund, the availability of additional funds, more money yet to be infused into this business for the purpose of promulgating a plan acceptable to the creditor body. The discussions continued up until this morning, and we have been in contact with the creditors' committee with regard thereto. We have not arrived at any figure.

THE REFEREE: You are going to do it quickly I tell you now.

MR. ITZLER: Here's the point I am trying to make, sir. Mr. Radom and I have discussed the possibilities of a plan. We have not discussed any particular figures. But we have a range where we would like Mr. Radom to go back to the trustees and submit the proposition to them to see how much can be made available for the purposes of the plan."

Tscpt. 3/24/70, Smp. 117, line 24 to Smp. 118, line 2:

MR BALLON: . . . I think with past experience with counsel and the creditors' committee, if we can't promulgate a plan, we will consent to an adjudication forthwith.

*see also supra pp. 22-23. Except where indicated, the transcripts, by stipulation, are not reproduced in the Appendix or Exhibit volume; they are, however, available to the Court upon request. Cf. A504-05, A754-756. In totality they consist of several hundred pages.

Tscpt. 8/25/70, Smp. 201, lines 17 to 25:

"MR. ITZLER: I want to make this clear to the Court and Mr. Hendler that the \$50 thousand good-faith deposit is part and parcel of the arrangement we are working out with the Pension Fund because it is the Pension Fund that is putting up the \$50 thousand.

Obviously, if we cannot work out an arrangement with the Pension Fund, the Pension Fund will not advance or take whatever steps are necessary."

Tscpt. 9/30/70, Smp. 244, line 5 to Smp. 245, line 6 (A761-62):

"MR. SCHAEFFER: No, your Honor.

So your Honor may place into context what has been discussed with respect to Masmo, may I advise you that negotiations toward Neisco's being able to consummate its settlement offer and a plan of arrangement to confirm involve a multitude of things. In order for the debtor to procure the moneys necessary to consummate its offer from the Fund, it would be necessary for the Fund to acquire all of the stock of Neisco so that it will then merge with its lien and thereupon proceed with the operation of the business toward a possible larger salvage than an immediate liquidation at the present time.

Unfortunately the negotiations were taking place between the representatives of the Fund and two individuals managing the debtor corporation. They are George Horvath and Ernest Horvath.

When the facts are uncovered we learned that George Horvath and Ernest Horvath do not own the stock of Neisco, Inc., and that a labyrinth of corporations, a whole corporate structure shows that ownership is in other persons out-

side the control of George and Ernest Horvath."

Tscpt. 10/20/70, Smp. 11, line 5 to Smp. 12, line 7 (A795-96):

"MR. SCHAEFFER: We hope so.

Maybe I can summarize the position of the Fund in this matter.

THE REFEREE: Yes.

* * *

The elimination of that unnecessary overhead would have brought us down to a near break-even point, permitting the Fund to continue negotiations of a host of problems, looking toward the confirmation of the plan of arrangement of Neisco, looking toward an arrangement reached with the trustee in bankruptcy of Masmo, whose affairs are interwoven with the Neisco affairs and, frankly, although not the matter before this Court, looking to an adjustment of a host of problems with respect to another property owned in common by the parent corporation.

Tscpt. 10/20/70, Smp. 19, lines 6-23:

"THE REFEREE: The application for a two-week adjournment in all respects, including an adjourned compliance with the imposition of indemnity, is granted.

What's going to happen in the next two weeks? I didn't quite get that too clear.

MR. ITZLER: There are a number of items which must be agreed upon between the Pension Fund, Neisco, the Horvaths, Masmo. We have already been

working on these items. Most of it has been in the talk stage. A lot of it has been in the paper stage. But we will start tomorrow with the service of Mr. Polish, I might add, and the services of Mr. Schaeffer's office, to putting this down on paper, having agreements that can be signed by all parties and maybe in two weeks -- and I say 'maybe' because there is a tremendous amount of work to be done -- we can have agreements."

Thereafter, hearings took place which further prove that the Fund did not enter into any agreement with plaintiff. The following excerpts indicate this:

Tscpt. 11/22/71, Smp. 22, line 19 to Smp. 23, line 13:

"THE REFEREE: We haven't even closed the first meeting.

MR. ITZLER: Well, the only reason that the first meeting is not closed, your Honor, is that although we do have the necessary consents in number and amount, I have not filed them because the creditors' committee has required the deposit of \$10,000 as good faith.

The \$10,000 is going to be used towards confirmation and consequently must come from the Pension Fund and as this Court well knows, the Pension Fund is not quite ready to put up any money whatsoever of any kind or nature until the other problems are straightened out.

I am confident that within the next day or so when those problems will be finally straightened out completely, that we can extract from the Fund the necessary \$10,000 so that we may close the first meeting and move to confirmation."

Tscpt. 2/1/72, Smp. 14, line 10 to Smp. 15, line 7:

"MR. ITZLER: I don't know that the Pension Fund is prepared to make that commitment to the attorney for the creditors committee.

THE REFEREE: Ten thousand dollars?

MR. ITZLER: Well, it really is a commitment to fund the Chapter 11 proceeding.

THE REFEREE: I had understood that what went on before the break had nothing to do with that at all.

MR. ITZLER: Well, your Honor, I represent the company. I have no knowledge at all as to what transpired.

THE REFEREE: Are we ready to confirm this arrangement quite apart from Ernest Horvath?

MR. ITZLER: I do not have the money to confirm.

THE REFEREE: How do I get the money?

MR. ITZLER: The only way is if the Pension Fund agrees to turn it over to Relasco to fund the Chapter 11."

It is quite obvious that the position taken by plaintiff during the Chapter XI hearings is completely at variance and inconsistent with the position it took in the court below. The district court did not err in so finding and its decision should be affirmed.

(c)

The written evidence discussed below leaves no doubt that there was no definitive agreement of any kind between the defendants and plaintiff or between the defendants and Neisco or the Horvaths. There were negotiations aplenty but there was no meeting of the minds on any basis where a contract of any kind matured. This documentation takes two forms: (i) the correspondence between the parties and their counsel, and (ii) the contemporaneous minutes of the Fund, which were made in the normal course of the Fund's operation, without any thought at that time of later litigation with plaintiff.

(i)

Plaintiff's exhibits 4, 5, 7 and 8 establish conclusively that there was no definitive agreement. These were not marked in chronological order but we shall discuss them in that fashion. The earliest letter of January 21, 1970 (Plf. exh. 7, E15), relating to Neisco, is addressed to Radom by Ballon. The second paragraph is significant since it points out that the Referee in Bankruptcy had requested a plan of arrangement to be presented to the court and that no plan had yet been formulated. We direct the Court's attention to the third paragraph where various details of a plan are discussed ("assuming that we could formulate a plan") which envisaged a

total payment of \$100,000 to both creditors and the government plus the necessary sums for administration expenses. The fourth paragraph of the letter attempts to convince the Fund to make funds available by suggesting that the operation of the company "had improved "beyond all expectations".* The next paragraph is equally significant: "Please give the problem of a possible plan of arrangement your immediate thought and consideration, since I must have an answer forthwith as to the intentions of the Fund with respect thereto." This is highly inconsistent language if plaintiff's theory and testimony were the fact.

Plaintiff's exhibit 8 (E18) is another Ballon letter dated March 30, 1970. This letter purports to make certain proposals "as a possible vehicle to be used to dispose of all existing problems." It then enumerates six separate items in numbered paragraphs, only one of which is the Neisco Chapter XI proceeding. The other items include releases from the Horvaths; transfer of three mills to the Horvaths; reconstituting the mortgage on the Montmarie property, and extending the

*Despite assurances to the bankruptcy court that Neisco would promptly after the filing of the Chapter XI petition become a profitable company, it actually lost money every month (Tscpt. 9/30/70, Smp. 247, line 16-Smp. 248, line 4, A764-65).

term and providing a moratorium of payments for a period of time, together with other radical changes in connection therewith including further advances; indemnification of the Horvath brothers from liability for withholding taxes in connection with Neisco and Masmo; the acquisition of certain assets of Masmo following its petition in bankruptcy (E18-20). This letter leaves no doubt that the parties were discussing an all around settlement ("to dispose of all existing problems" E18) and not isolated piece-meal disposition of separate areas of controversy.

The next letter, April 8, 1970 (Plf. exh. 5, E8) followed a meeting of April 6 at Ballon's office and again makes new proposals - "Since the counter proposals at the meeting in our offices were not completely satisfactory to Messrs. Horvath." This letter enumerates seven areas of dispute, only one of which is the Neisco situation and brings in new items which were not mentioned in January.

The next letter, dated April 21, 1970 (Plf. exh. 4, E4), purports to confirm various points discussed at a meeting the previous day. This too is from Ballon to Radom. Significantly the third paragraph of the letter reads "If the items hereinafter recited are satisfactory, it is my suggestion that we arrange to incorporate them in an agreement, so that we may go in all future actions in accordance therewith and without any future problems

arising between the parties." This, of course, is the whole point; no agreement was ever arrived at and no document was ever signed. The letter goes on to recite nine separate areas of controversy, one of which, number nine (E6-7), relating to Montmarte, has six separate subdivisions.

It seems absolutely conclusive, from a review of these documents, that the parties were attempting to settle their overall differences and until they resolved everything, they resolved nothing. It was not until July 27, 1970 (Plf. exh. 16, E92) that draft agreements were prepared and sent by plaintiff to counsel for the defendants, but these agreements were not acceptable and were concededly never signed. It is apparent, therefore, that the concept of a definitive agreement by the Fund to pay plaintiff's fees willy-nilly or to underwrite any plan of arrangement without any conditions or limitations of amount is no more than wishful thinking and rationalization on plaintiff's part.

(ii)

The second group of documents which indicates the negotiating character and the tentative quality of all of the discussions is the minutes of the meetings of the Pension Fund (Def. exh. F; cf E243; printed at A57 et seq).

The defendants, as trustees, could not act, nor authorize action on their behalf except as they resolved at a

meeting of the full board, or of the steering committee which supervised operations between meetings (A535). Plaintiff specifically acknowledged this in the Neisco hearings in the Bankruptcy Court (Tscpt. 2/24/70 Smp. 98-100), and in the complaint (A22).

These minutes, which are marked Exhibits A through L inclusive in Exhibit F show exactly what the Trustees agreed to, what they did not agree to, and what the problem was in dealing with the Horvaths. We particularly direct the Court's attention to Exhibit G (A83-87), a meeting of the steering committee of July 31, 1970 and Exhibit H (A88-89), a meeting of the full Board of Trustees of August 6, 1970. At these meetings stand-by authority was given to counsel for the Fund to proceed with foreclosure, if and as required. We also direct the Court's attention to exhibit I (A90-97), a meeting of the full Board of Trustees of February 4-5, 1971, at which a comprehensive plan of compromising all of the Horvath claims was discussed but which was never consummated (cf A242-44).

It is quite clear from a review of the minutes that negotiations were continuous and strenuous but that these negotiations never materialized into a confirmed plan of arrangement. More specifically, nowhere in any of the minutes is there any reference to an agreement to pay plaintiff's fees directly, indirectly, or otherwise.

Clearly, the court below was correct in concluding that there was no factual basis for plaintiffs claim that an agreement of any kind was entered into by defendants to pay its counsel fees, or to fund a plan of arrangement of Neisco in Chapter XI that did not require the specific approval of the defendants. Its decision in that regard should be affirmed.

POINT II

THE FINDING OF THE DISTRICT COURT
THAT THERE WAS NO EVIDENCE TO SUSTAIN
THE SECOND CAUSE OF ACTION BASED IN
FRAUD IS FULLY SUPPORTED BY THE RECORD.

We shall devote very little time to discussion of this point. Appellant has not discussed the issue in its brief, so that we may assume that it has been abandoned.

The only thing the Fund specifically undertook to do was to advance up to \$1,600,000 in an effort to rehabilitate Neisco, and it actually did that. The cause of action for fraud cannot be based upon a simple failure to perform a contract or upon the failure to realize future hopes. To support a claim based upon fraudulent intention, there must be proof that a defendant had an intention not to perform at the time its representation was made. Miller v. Volk & Huxley, Inc., 44 A.D.2d 810, 355 N.Y.S.2d 605 (1st Dep't 1974), Gerard v. Environmental Research and Development, 175(37) NYLJ, February 25, 1976, p. 7, col. 5.

There is not a scintilla of evidence suggesting such a possibility in the case at bar and the district court so found (A833). Plaintiff Ballon himself so admitted (A296-98). Its decision in this regard should be affirmed.

POINT III

PLAINTIFF IS ESTOPPED FROM RECOVERING
IN THIS ACTION BY REASON OF NONCOMPLIANCE
WITH THE RULES IN BANKRUPTCY.

The point raised is not merely a technical one of noncompliance with the bankruptcy statute and local court rules. It is that in part of course. More importantly, however, it presents the extremely important public policy question of whether the federal courts should enforce a secret agreement which could be to the detriment of the estate and the creditors of a bankrupt, where disclosure is required for the very purpose of avoiding that result.

The applicable bankruptcy rules are reproduced in an appendix to this brief (*infra*, p. 50). They are Bankruptcy Rule 215, formerly General Order 44, and Rule 10 of the Bankruptcy Rules of the Southern District. General Order 44 and Bankruptcy Rule 215, in their application to the issue before the Court, are virtually identical.

General Order 44, as well as the present Rule 215, requires that an applicant for appointment as attorney for a trustee or a debtor in possession must disclose all "connections" with any adverse interest. An applicant must advise the court of "all of the attorneys' * * * connections with the bankrupt, the creditors, or any other party in interest, and their respective attorneys and accountants."

For the plaintiff to maintain, as it does, that its alleged agreement with the Fund does not constitute a "connection" with an "adverse" party is patently absurd.

"Connection" is a broad term, designed to disclose any influence that might motivate counsel in any direction other than benefit to the estate and its general creditors. If a contract to advance the interest of a creditor is not a "connection"; if an agreement to pay \$100,000 for legal services is not a "connection"; the word as used in the General Order has no meaning.**

Similarly, it is clear beyond peradventure of doubt that the Fund was an "adverse party," vis the Fund was not only the largest creditor of the debtor, it was also a lien creditor whose priority came ahead of everyone else*, including the

*The debtor in possession, as a receiver or trustee in bankruptcy has the duty to challenge all liens which may be attacked. Cf. Bankruptcy Act, Sec. 342; 8 Collier on Bankruptcy 14th ed. pp. 941-51 paragraphs, 7-7.5.

**The word connection is defined, among other things, as "the state of being connected." "A social, professional or commercial relationship as (a) position, job, (b) an arrangement to execute orders or advance interest of another." The word connect(ed) is defined as "to place or establish in relationship". (Webster's Seventh New Collegiate Dictionary, G & C Merriam Company, Springfield, Massachusetts, 1971, p. 176.)

Connection is also defined in another dictionary as "3. a relation; associations; specifically, * * * (d) relation by family ties, business, etc." (Webster's New World Dictionary of the American Language, World Publishing Company, Cleveland, New York, 1956, p. 311.)

United States Government.* It is a certainty that if the agreement alleged to have existed between plaintiff and the Fund had been brought to the attention of the Bankruptcy Court it would not have permitted plaintiff to act.

The only real issue that is presented here is: What is the consequence of plaintiff's misconduct? Judge Swan's landmark decision in In re Rogers-Pyatt Shellac Co., 51 F.2d 988 (2d Cir. 1931) is illuminating in this regard.

Rogers-Pyatt was decided on the basis of General Order 44. Under existing Bankruptcy Rule 10 of the Southern District, General Order 44 sets the standard for the appointment of counsel. While the case specifically deals with the appointment of an attorney for a receiver, its holding is directly pertinent to the case at bar. In that case, the attorneys were appointed on petition of the receiver supported by an affidavit of one of the members of the law firm. The affidavit failed to mention the fact that the attorneys were also the attorneys for the petitioning creditors, and that two of such creditors were also stockholders and directors of the bankrupt. One was also secretary and his claim was in dispute. The attorneys later

*It would have been the burden of plaintiff as counsel for the debtor in possession carefully to check and attack any lien of the defendants against the Neisco property which might have been invalid either because of faulty filing, bribery, fraud, or irregularity of any kind. To suggest, as one of plaintiff's partners did on cross-examination, that he could conceive of no conflict of interest between the Fund and the general creditors is astonishing (cf A448-57).

claimed that the true facts had been orally disclosed to the court. The following excerpts from the opinion have direct relevance to the situation at bar (at p. 991):

"These facts should have been disclosed in the affidavit, and, had they been, the affidavit would not have made the showing required by General Order 44 to authorize the appointment of the appellants as attorneys for the receiver; for there is a plain implication in the language of the general order that an attorney employed by any person having an interest adverse to the receiver, trustee, or creditors is not to be appointed counsel for the receiver."
(Emphasis added)

In respect of the local rule, the court stated (pp. 991-92):

*

*

*

"If it be assumed that, notwithstanding, the rule would have permitted the court to authorize their employment, this could only have been 'for good cause shown by such attorney's affidavit'; and no such showing was made. Nor does the entire record disclose any reason why the appellants, rather than other attorneys of equal professional standing and competence who had no relation to the petitioning creditors, should have been chosen to represent the receiver, except the reason that they already represented the petitioning creditors. But that fact is a reason for not employing them, which may be overcome only for good cause. Therefore, so far as appears, they would not have been appointed had the affidavit made the disclosure which rule 4 required." (Emphasis added)

The principle is generally accepted in other circuits where it has come up. Albers v. Dickinson, 127 F.2d 957 (8th Cir., 1942); In re Hydrocarbon Chemicals, Inc., 411 F.2d 203, 206 (3d Cir.) (en banc), cert. denied, Neiwirth v. Hydrocarbon Chemicals, Inc., 396 U.S. 823 (1969).

The underlying purpose of General Order 44 is carried out in the Code of Professional Responsibility, as adopted by the American Bar Association and the New York State Bar Association. Two subsections of the section labeled "Desires of Third Persons" read as follows:

"EC 5-21 The obligations of a lawyer to exercise professional judgment solely on behalf of his client requires that he disregard the desires of others that might impair his free judgment. The desires of a third person will seldom adversely affect a lawyer unless that person is in a position to exert strong economic, political, or social pressures upon the lawyer. These influences are often subtle, and a lawyer must be alert to their existence. A lawyer subjected to outside pressures should make full disclosure of them to his client; and if he or his client believes that the effectiveness of his representation has been or will be impaired thereby, the lawyer should take proper steps to withdraw from representation of his client.

"EC 5-23 A person or organization that pays or furnishes lawyers to represent others possesses a potential power to exert strong pressures against the independent judgment of those lawyers. . . ."

The requirement to make full disclosure of these influences to its client required plaintiff in this case to make full disclosure of its alleged agreement with the Fund to the Bankruptcy Court and to the general creditors of Neisco. The general creditors were the "clients" whose interests were adverse to the Fund's position as a lienor and they, as well as the Court, were the ones who should have been notified of the alleged agreement. It was to the general creditors that the debtor in possession occupied the relationship of trustee under Section 342 of the Bankruptcy Act. When plaintiff made application to the Bankruptcy Court for an order authorizing its retention, it was obligated not only to comply with the strict provisions of General Order 44, but to the requirements of disclosure of the Code of Professional Responsibility. When it applied for appointment as counsel, ex parte, it had a duty to inform the Bankruptcy Referee of any alleged agreement affecting its conduct of the Chapter XI proceeding. It was the Referee's responsibility, not plaintiff's, to determine, after disclosure, whether plaintiff should be appointed.

If, as plaintiff maintains, it had a fee arrangement with the Fund, it did not comply with General Order 44; it did not disclose a position of direct conflict of interest and certainly, a "connection" potentially detrimental to the estate. To afford plaintiff any recovery in this action, for services performed under circumstances that would have prevented

it from acting at all as counsel to the debtor had it made the required disclosure, is against public policy.

To limit the consequences of plaintiff's misconduct to the mere denial of any award of fees by the Bankruptcy Court is to acknowledge and disregard reprehensible conduct committed in the very presence of the court. This must not be tolerated. The high standards of bench and bar in this Circuit require that plaintiff be estopped from invoking the aid of the federal court to recover from defendants for the services rendered by it in the Chapter XI proceeding.

Lest the Court be swayed by sympathy for plaintiff's plight, we refer to a quotation from Judge Swan in this connection in Rogers-Pyatt, supra (p. 38) where a similar argument was made to support the contention that the order authorizing the appointment should be amended nunc pro tunc to permit the missing statements in the affidavit to be made. The court stated, p. 992:

"nor is there merit in the contention that the appointment should now be authorized nunc pro tunc. The only argument in favor of a nunc pro tunc order is that of hardship. But the hardship is of the appellant's own making. The rule is clear, and they are charged with knowledge of it. To give heed to the argument of hardship in such circumstances would nullify the requirement that the affidavit be filed before the appointment is made. One reason for that requirement is obviously to allow the court to consider the grounds advanced for selecting counsel presumptively disqualified by represent-

ation of the petitioning creditors, unaffected by the emotional pressure which inevitably arises in their favor after the services have been rendered. Attorneys who seek appointment as counsel for an officer of the court owe the duty of complete disclosure of all facts bearing upon their eligibility for such appointment. If the duty is neglected, however innocently, surely they should stand no better than if it had been performed. In the present case, had the facts been disclosed, the appellant would not have been appointed counsel for the receiver. If the rule is to have vitality and the evils against which it is aimed are to be eliminated, it should be enforced literally."

POINT IV

THE COURT HAS NO JURISDICTION OF THIS
ACTION BY REASON OF THE DEFENDANTS'
NONRESIDENCE, LACK OF PROPER SERVICE
AND THE INAPPLICABILITY OF CPLR 302

As a removed diversity case, jurisdiction must be found not only upon the requirements of the Judicial Code as to diversity of citizenship and the amount in controversy (28 U.S.C. sections 1441(a), 1332), but also upon the proper service of process and the existence of facts bringing the case within CPLR Section 302, the New York Long Arm Statute, or the Federal equivalent concept of jurisdiction. The issue is preserved for decision by the court after removal. Wabash Western Ry. v. Brow, 164 U.S. 271 (1896); Mechanical Appliance Co. v. Castleman, 215 U.S. 437, (1910); Cain v. Commercial Pub. Co., 232 U.S. 124, (1914).

In this case, none of the trustees was served within the State or within 100 miles of the district. (A750-51). (Fed. R. Civ. P. 4). All of them are residents of states other than New York. There is, therefore, no service of process to begin with upon which to base the action unless the case falls within CPLR Section 302, or its federal equivalent standard. Weinberg v. Colonial Williamsburg, Inc. 215 F. Supp. 633 (E.D.N.Y. 1963).

The defendants do not transact business in New York. Their office is in Chicago, the loans were made in Chicago, and the fact that people come to them from New York (and other places) to borrow money, does not constitute the transaction of business in New York. Weinberg v. Colonial Williamsburg, Inc. supra; Williams v. Modern Home Life Ins. Co., 260 F. Supp. 649 (D.S.C. 1966).

The alleged agreement upon which plaintiff relies was made in Chicago.* Not only, however, must there be a "transaction" of business but the cause of action must be based upon and arise out of that act. Fontanetta v. American Board of Internal Medicine, 421 F.2d 355 (2d Cir. 1970).

The test of jurisdiction is "that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protection of its laws". Hanson v. Denckla, 357 U.S. 235, 253 (1958); cf. Longines-Wittnauer Watch Co. v. Sames & Reinecke, 15 N.Y.2d 443 (1965); Del Bello v. Japanese Steak House, Inc. 43 A.D.2d 455, 352 N.Y.S.2d 537 (4th Dept. 1974); Bernard v. Richters Jewelry Co., 53 F.R.D. 606 (S.D.N.Y. 1971).

*Note, that the "consideration" in part for the alleged agreement is the preparation and filing of the petition under Chapter XI (Complaint paragraph Seventh, Fifteenth), all of which was necessarily agreed to, if at all, before November 24, 1969 in Chicago.

The only acts performed on behalf of defendants in New York were by the Fund's counsel to salvage its interest in the Chapter XI proceeding and the actions of the Fund's court approved independent contractor, Rugendorf, in countersigning checks during the Chapter XI proceeding to prevent diversion of funds by Neisco. Neither of these series of actions has anything to do with the basis for the cause of action which is an alleged contract of hire. We suggest that it is beyond the power of New York to subject a nonresident to in personam jurisdiction where it comes to New York to participate in a federal court proceeding to protect its assets or interest in the estate of a New York debtor, where the initial transaction was made in a state other than New York.

Rugendorf was not acting as an agent of the Fund in any sense. He was an independent contractor (Bankruptcy Minutes, 9/17/70, Smp. 120-21, Smp. 135-41) and he was acting under order of the Bankruptcy Court.* This is not the kind of "business" the transaction of which subjects a nonresident to personal jurisdiction under CPLR Section 302.

Furthermore, the acts of an independent contractor are not the acts of the principal from the viewpoint of creating jurisdiction and do not subject nonresidents to in

*Order authorizing the borrowing of funds, dated November 24, 1969, 69-B-769, provided: "Ordered that all checks drawn by the debtor-in-possession *** shall be countersigned by Irwin I. Rugendorf, Executive Vice President of American Revenue Corporation, or such other person as the Central States, Southeastern and Southwestern Areas Pension Fund may from time to time designate."

personam jurisdiction. Glassman v. Hyder, 23 N.Y.2d 354, 362 (1968) (a real estate broker acting for a nonresident owner); Winick v. Jackson, 49 Misc.2d 1009, 268 N.Y.S.2d 768 (Sup. Ct. 1966) (a lawyer acting for a nonresident in a probate proceeding); Galgay v. Bulletin Co., 504 F.2d 1062 (2d Cir. 1974).

We also suggest that the fact that the Chapter XI proceeding was pending in the federal court requires a denial of New York jurisdiction since the federal court system cannot be subject to restrictions based upon state statutes, which would impair its functioning by keeping litigants out of Federal Court who would otherwise be needed there to protect their interests. Even the alleged agreement upon which plaintiff relies, had to do with Federal proceedings, in a Federal Court without the slightest participation in any New York transaction per se. There were no liens perfected in New York (Neisco's plant and physical assets were in North and South Carolina). There was no transaction in New York other than such as was incident to the Federal Court proceeding. There was, in short, no New York contact upon which to base jurisdiction. The transactions involved in this case upon which the complaint is based took place in Chicago and this Court has no jurisdiction to entertain this action under the New York Long Arm Statute.

CONCLUSION

The district court did not err in concluding that plaintiff has made out no case for recovery on contract, fraud, or any other theory. The nature of its claim is such that it is estopped from recovering by reason of its failure to disclose its alleged connection with the defendants under Bankruptcy Rule 215 and Southern District Rule 10. Furthermore, the action should be dismissed because the district court had no jurisdiction of the defendants, all of whom are nonresidents and none of whom was served in New York State.

Respectfully submitted,
GREENBAUM, WOLFF & ERNST
Attorneys for Defendants

OF COUNSEL:

Sydney J. Schwartz
Laurence Vogel

SCHEDULE A

Allowed general claims (Tscpt. 2/22/72, Smp. 2, line 7- Smp. 3, line 5	\$ 696,000*
U.S. Government claim	455,000** (A511)
Administration Expense per Ballon: plaintiff's fees (additional)	75,000 (A180-83)
Attorneys for Creditors' Committee	25,000 (A179)
Miscellaneous and Secretary	<u>6,000</u> (A179)
	\$1,257,000 (cf A725)

*If a Masmo claim is added, the total is over \$900,000 (Tscpt. 2/23/72, Smp. 16, lines 20-24).

**Variously filed at \$700,000 (Tscpt. 2/23/72, Smp. 18, lines 16-18) and \$1,307,285 (Def. exh. K, id E305; cf. A511).

ADDENDUM TO APPELLEE'S BRIEF

Bankruptcy Act, Section 342:

"Sec. 342. Where no receiver or trustee is appointed, the debtor shall continue in possession of his property and shall have all the title and exercise all the powers of a trustee appointed under this Act, subject, however, at all times to the control of the court and to such limitations, restrictions, terms, and conditions as the court may from time to time prescribe."

Bankruptcy Rule 215:

"(a) Conditions of Employment of Attorneys and Accountants. No attorney or accountant for the trustee or receiver shall be employed except upon order of the court. The order shall be made only upon application of the trustee or receiver, stating the specific facts showing the necessity for such employment, the name of the attorney or accountant, the reasons for his selection, the professional services he is to render, and to the best of the applicant's knowledge all of the attorney's or accountant's connections with the bankrupt, the creditors, or any other party in interest, and their respective attorneys and accountants. If the attorney or accountant represents or holds no interest adverse to the estate in the matters upon which he is to be engaged, and his employment is in the best interest of the estate, the courts may authorize his employment. Notwithstanding the foregoing sentence, the court may authorize the employment of an attorney or accountant that has been employed by the bankrupt when such employment is in the best interest of the estate. The employment of any attorney or accountant shall be only for the purposes specified in the order, but the court may authorize a general retainer of an attorney when necessity therefor is shown.

(b) Employment of Attorney or Accountant with adverse Interest. If without disclosure any attorney or accountant employed by the trustee or receiver shall represent or hold, or shall have represented or held, any interest adverse to the estate in any matter upon which he is so employed, the court may deny the allowance of any compensation to such attorney or accountant, or the reimbursement of his expenses, or both, and may also deny any allowance to the trustee or receiver if it shall appear that he failed to make diligent inquiry to the connections of such attorney or accountant."

Bankruptcy Rule 11-22:

Bankruptcy Rule 215 applies in Chapter XI cases to the employment of attorneys and accountants for a trustee, receiver, debtor in possession, or creditors' committee selected pursuant to Rule 11-27.

Rule 10 of the Bankruptcy Rules of the Southern District:

"All petitions to retain an attorney for a receiver, trustee, or debtor in possession shall comply with General Order 44. The showing of necessity shall be factual.

The attorney for petitioning creditors shall not be retained as attorney for the receiver, trustee or debtor in possession unless his affidavit shall show that he did not file the petition or become the attorney for the petitioning creditors at the instance of or pursuant to any arrangement with the Bankrupt or anyone acting on his behalf.

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Ballon, Stoll & Itzler,
Plaintiff-Appellant,

against

Thomas J. Duffey, Herman A. Leuking, Jr., Albert D. Matheson,
William J. Kennedy, John A. Murphy, Jack A. Sheetz, John Sprickerman,
Frank E. Fitzsimmins, Robert Holmes, Donald Peters, William Presser,
Odell Smith, Roy L. Williams, Frank H. Ranney and Joseph Morgan, not
individually, but as Trustees Under a Common Law Trust of the Central
States Southeast and Southwest Areas Pension Fund,
Defendants-Appellees.

AFFIDAVIT
OF SERVICE

STATE OF NEW YORK,

COUNTY OF NEW YORK, ss:

Bernard S. Greenberg

deposes and says that he is over the age of 21 years and resides at ^{being duly sworn,} 162 E 7th St N.Y., N.Y.

That on the 27th day of April 1977 at 1180 6th Ave NY, NY
he served the annexed Brief for Defendants-Appellees upon

Ballon, Stoll & Itzler

Attorneys for Plaintiff-Appellant

1180 Sixth Ave.

N.Y., N.Y.

in this action, by delivering to and leaving with said attorneys

3 true copies thereof.

DEPONENT FURTHER SAYS, that he knew the person so served as aforesaid to be the person mentioned and described in the said

Deponent is not a party to the action.

Sworn to before me, this 27th
day of April 1977

Roland W. Johnson
ROLAND W. JOHNSON

Notary Public, State of New York

No. 4509705

Qualified in Delaware County
Commission Expires March 30, 1979

Bernard S. Greenberg

Service of three (3) copies of
the within _____ is
hereby admitted this.. day
of _____, 197

Attorney for